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UNCLAS SECTION 01 OF 02 COLOMBO 000086

SIPDIS

DEPARTMENT FOR SA/INS, EB  
PASS TO USTR:AWILLS  
COMMERCE FOR ITA:ABENAISSA  
TREASURY FOR SRI LANKA DESK:RADKINS

E.O. 12958: N/A

TAGS: [ECON](#) [ETRD](#) [CE](#) [USTR](#) [ECONOMICS](#)

SUBJECT: SRI LANKAN ECONOMY GROWS 5.5% IN THIRD  
QUARTER

1. Summary: The Sri Lankan economy expanded by 5.6% in the third quarter, in line with the projected growth of 5.5% for 2003. The Central Bank said the 5.5% growth for the full year was still achievable, despite recent political divisions and uncertainties. The Central Bank, however, stressed that continued peace, political stability and speedy implementation of infrastructure projects will be key to maintain momentum and achieve the higher 6% growth projected in 2004. End Summary

#### Services boost economy

2. The Sri Lankan economy expanded by 5.6% in the third quarter of 2003 contributing to an average 5.6% growth rate in the first three quarters, compared with 2.9% growth in the same period in 2002. Significantly, this was the fifth straight quarter in which growth exceeded 5.5%. The positive results in the third quarter were mainly driven by strong (8.3%) growth in the services sector, which contributed 79% to overall growth. Banking, trading, communications, port services and tourism posted double digit growth during this period. In 2003, tourist arrivals reached 500,000 for the first time, up 27% from 393,000 arrivals in 2002.

#### Other sectors

3. Third quarter industrial sector performance was rather disappointing at 2.8% growth. The sluggish growth was mainly due to lower value addition in apparel manufacturing sector, where factories are trying to streamline their operations to meet the MultiFiber Arrangement phase out in 2005. The construction sector grew by 5.9% and agriculture grew by 2.1%, with the tea, coconut, and rice sectors recording robust growth rates of over 5%.

#### External performance through October

4. On the external front, exports rose by 11% through October, in contrast to a drop of 6% in 2002. Imports increased by 9%, against a decrease of 3% in 2002. The trade deficit increased marginally to \$1.14 billion from \$1.11 billion in 2002. Foreign exchange inflows from tourism, ports, private remittances and capital transfers increased, contributing to reserves and improving foreign exchange liquidity. Foreign reserves reached \$3.1 billion in October, up 25% from January 2003, providing 5.7 months of import cover.

#### Earlier reforms support growth

5. Strong growth in the first three quarters reflects the positive response to improved macroeconomic conditions. The main contributory factors to growth were peace, improved macro economic management, greater fiscal discipline (budget deficit is forecast at 7.8% of GDP in 2003), declining interest rates, stability of the rupee, falling inflation (inflation fell to 6.3% in 2003 from 9.6% in 2002), increased foreign inflows, increased power supply, improved business confidence and some recovery in the world economy.

6. The Central Bank said the challenge now is to achieve the medium term growth target of over 6%. Without such an expansion it will be difficult to improve education and employment opportunities, income generation, living conditions, and quality of life in a sustainable manner. The higher growth would require increased investments, which in turn will require political stability, peace, further improvements in macro economic management, acceleration of reforms, reducing economic policy uncertainties and effective utilization of foreign assistance to improve infrastructure.

17. Comment: The 10 month momentum of the peace process and economic reform programs of the government this year resulted in strong third quarter performance. The current political disturbance, begun in early November, has had a negative impact on the economy, though it may not be severe enough to affect the 2003 targets significantly. The effect is expected to be felt more strongly in the early months of 2004. End comment.  
Lunstead